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IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1970

No. 235

STANLEY, INC.,

Petitioner,

vs.

PAUL A. SCHUSTER, District Director,
Internal Revenue Service,

Respondent.

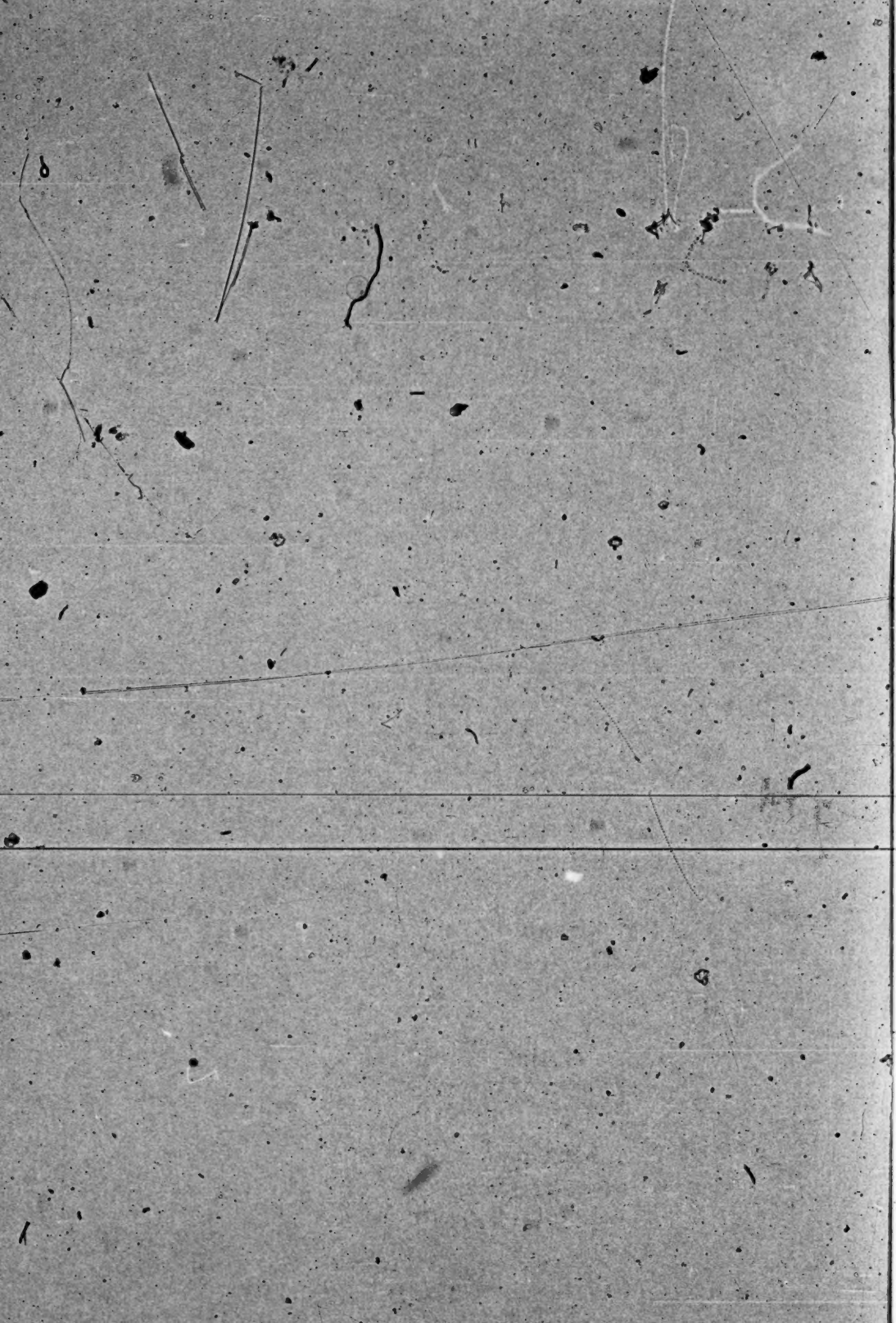
On Petition for a Writ of Certiorari to the
United States Court of Appeals for
the Sixth Circuit

REPLY BRIEF OF THE PETITIONER

JOHNNIE M. WALTERS
Assistant Attorney General
LEE A. JACKSON
JONATHAN S. COHEN
ANN BELANGER
Attorneys
Tax Division
Department of Justice
Washington, D. C. 20530
Of Counsel:
WILLIAM W. MILLIGAN
United States Attorney
Counsel for Respondent.

ROBERT H. HOFFMAN,
KATHELEEN K. HAASE,
17 South High Street
Columbus, Ohio 43215
Counsel for Petitioner.

MIDWEST LAW PRINTERS AND PUBLISHERS, INC., Columbus, Ohio 43216



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ARGUMENT

Argument 4. of the Brief For The Respondent In Opposition contains new matter. In that argument, the respondent asserts that Section 385 of the Internal Revenue Code (Tax Reform Act of 1969, Section 415(a), P.L. 91-172, 83 Stat. 613) renders further review of this question inappropriate at this time.

Section 385 of the Code authorizes the Commissioner to issue regulations providing rules for distinguishing between debt and equity. The enactment of

Section 385 reflects a congressional belief that debt equity questions are of considerable importance. But, by merely authorizing the Commissioner to issue regulations rather than by incorporating rigid tests into the Code itself, Congress has left with the courts an outstanding opportunity to provide practical guidelines on which the Commissioner can base any regulations drafted pursuant to Section 385. Because the present state of the law is ill defined, this opportunity for the courts to continue to decide debt-equity cases, particularly in light of the ever increasing number of such cases which are reaching the courts, should not be overlooked. While there are many decided debt-equity cases, these cases have tended to be decided on an ad hoc basis, frequently using different criteria adopted in a most unpredictable manner and therefore rendering a reconciliation of the cases impossible.

Virtually all of the criteria which have been used in the decided cases to distinguish debt and equity are factors in the instant case. Thus, this case offers this Court an excellent occasion to spell out what the relative importance of each of these criteria is under the present law, which in turn could be a valuable guideline to the Commissioner in drafting regulations pursuant to Section 385.

CONCLUSION

For the reasons stated in the Petition For A Writ Of Certiorari and in this Reply Brief Of The Petitioner, the Petition for a Writ of Certiorari should be granted.

Respectfully Submitted,

Robert H. Hoffman

ROBERT H. HOFFMAN

Kathleen K. Haase

KATHELEEN K. HAASE
Counsel for Petitioner

Date: August 19, 1970

APPENDIX A

Internal Revenue Code of 1954 (26 U.S.C.):

SEC. 385 [as amended by Sec. 415(a), Tax Reform Act of 1969, P.L. 91-172, 83 Stat. 613]. TREATMENT OF CERTAIN INTERESTS IN CORPORATIONS AS STOCK OR INDEBTEDNESS.

(a) *Authority to Prescribe Regulations.*—The Secretary or his delegate is authorized to prescribe such regulations as may be necessary or appropriate to determine whether an interest in a corporation is to be treated for purposes of this title as stock or indebtedness.

(b) *Factors.*—The regulations prescribed under this section shall set forth factors which are to be taken into account in determining with respect to a particular factual situation whether a debtor-creditor relationship exists or a corporation-shareholder relationship exists. The factors so set forth in the regulations may include among other factors:

(1) whether there is a written unconditional promise to pay on demand or on a specified date a sum certain in money in return for an adequate consideration in money or money's worth, and to pay a fixed rate of interest,

(2) whether there is subordination to or preference over any indebtedness of the corporation,

(3) the ratio of debt to equity of the corporation,

(4) whether there is convertibility into the stock of the corporation, and

(5) the relationship between holdings of stock in the corporation and holdings of the interest in question.